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SUBJECT: FRENCH NATIONAL STATISTICAL AGENCY REVISES DOWNWARD 2007
GDP GROWTH

REF: Paris 2791

11. (U) SUMMARY: INSEE, the French National Statistical Agency, forecasts real GDP to increase 1.8 percent in 2007 compared with 2.2 percent in 2006. Similar to OECD and European Commission forecasts, INSEE's projections are below the lower bound of the GOF's 2.0-2.5 percent forecast. Nonetheless, the government continues to stick to its forecast, in part because delivering economic growth messages is vital to rally support for deep reforms. END SUMMARY

INSEE Forecasts GDP to Increase 1.8 Percent in 2007

12. (U) In its latest quarterly note, INSEE revised downward its 2007 real GDP growth forecast to 1.8 percent from the 2.1 percent estimate of June (reftel). The revised forecast takes into account the low 1.2 percent (working-day corrected; seasonally adjusted; annualized) increase in Q-2, which was due in part to moribund corporate investment and a decline in German industrial production. INSEE expects an upswing in the second half, forecasting GDP to increase 2.8 percent (working-day corrected; seasonally adjusted; annualized) in Q-3 in line with France's euro partners, notably Germany, and 2.0 percent (working-day corrected; seasonally adjusted; annualized) in Q-4. The expected growth in Q-3 represents a "simple technical rebound" from the second quarter. Summer turbulence on the financial markets is expected to have a moderate impact on economic growth in Q-4. Looking ahead, the potential for continued turbulence is the main factor of uncertainty in INSEE's forecast.

Consumption Remains the Main Motor of Economic Growth

13. (U) Household consumption of manufactured products has rebounded since June. INSEE forecasts strong household consumption in the second half of 2007, leading to an annual increase of 2.1%. It would remain the main motor of economic growth. Although INSEE's September survey of household confidence showed increased pessimism about prospects for improvement in standards of living, INSEE analyst Pierre-Olivier Beffy argues that consumption will be driven by an increase in purchasing power and an improvement in the labor market. Household disposable income is expected to increase 3.2 percent in 2007 thanks to higher income and cuts in income and payroll taxes in the second half. However, real disposable income growth will slow in the second half as inflation accelerates from an annual rate of 1.3 percent in August to 1.9 percent in December. INSEE based its forecast on oil prices at USD75 per barrel by the end of the year.

14. (U) Tax Package: INSEE estimates that income and payroll tax

cuts for employees working overtime will result in 420 million euro additional income, or a 0.14 percent increase in household disposable income in 2007. Cuts in inheritance taxes should put 360 million euros in households' pockets this year.

Job Creation is Significant

15. (U) Job creation in the first half (212,000) was significant. INSEE forecast the economy will create 340,000 jobs in 2007 compared to 285,000 in 2006. Government-subsidized contracts will decline, but the private-sector will create up to 255,000 jobs. INSEE warned that unemployment figures may be affected by a current review of how jobless numbers are calculated in France. There are some indications that the revised unemployment rate will be higher than the current 8.0 percent (using ILO definitions). INSEE will publish the unemployment rate on a quarterly basis (versus monthly), starting with data for Q-3.

INSEE Optimistic about Corporate Investment

16. (U) Despite a sluggish second quarter, INSEE argues that corporate investment in France remains strong. Production of goods and services is forecast to pick up in the second half, reflecting improving business confidence and recovery in the automobile industry. INSEE forecasts corporate investment to increase 4.9 percent in 2007 compared with 4.6 percent in 2006 thanks to an acceleration of investment growth in the second half.

Contribution of Foreign Trade Remains Negative

17. (U) Imports of manufactured products will be spurred by strong consumption, while exports of manufactured products will experience a "mild" loss of competitiveness due to the strength of the euro and less dynamic foreign demand. However, brisk demand for food and

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energy exports (due to an unusual rise in exports of refined oil products in July) would bring the current account into balance in the second half. That said, the overall contribution of foreign trade to GDP growth in 2007 is estimated at minus 0.3 percent.

Government Sticks to Its GDP Growth Forecast

18. (U) INSEE's forecast is in line with OECD forecasts, but below the European Commission's of 1.9 percent and significantly below the government 2.0-2.5 percent forecast. Despite the INSEE report, Finance Minister Lagarde continues to support the government's GDP growth forecast. In introducing the 2008 central government budget on September 26, she stressed that "economic indicators - including consumption of manufactured products, industrial production and the business climate surveys - are (flashing) green." Meeting government GDP forecast would require 3.2 percent (working-day corrected; seasonally adjusted; annualized) GDP growth in Q-3 and Q-4, considerably above the respective estimates of 2.8 percent and 2.0 percent.

19. (U) In response to Embassy probing INSEE officials indicated that a higher-than-expected increase in industrial production (thanks to orders in the automobile sector) could boost GDP growth by 0.1 percent and bring French growth closer to the government's target. However, INSEE Chief Economist Eric Dubois indicated that "the probability of such increase is lower than 50 percent."

Comment

10. (SBU) The modest pace of GDP growth will complicate GOF efforts to reduce the budget deficit in 2007 (septel). However, while the tax package passed in July will aggravate the 2007 budget deficit, it may have a positive impact on economic growth in 2008 and 2009. The GOF undoubtedly sees delivery of near-term economic growth as important to its efforts to rally support for reform, and thus as justification of demand-side fiscal stimulus to help achieve the longer-term supply side measures the French economy requires.

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